

## Message Text

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INFO OCT-01 EUR-12 EA-07 NEA-10 ISO-00 IO-11 H-02 L-03

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R 310800Z JAN 76

FM AMEMBASSY ISLAMABAD

TO SECSTATE WASHDC 3930

INFO AMEMBASSY COLOMBO

AMEMBASSY DACCA

AMEMBASSY KABUL

AMCONSUL KARACHI

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AMEMBASSY MANILA

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MANILA PASS USADB

E.O. 11652: N/A

TAGS: EGEN, PK

SUBJECT: PAKISTAN ECONOMY - YEAR-END ASSESSMENT

1. SUMMARY. PAKISTAN'S ECONOMY AS THE NEW YEAR BEGINS IS CONTINUING TO PERFORM IN USPECTACULAR FASHION. THOUGH OVERALL OUTPUT FOR FY/76 MAY BE SLIGHTLY HIGHER THAN LAST YEAR'S THREE PERCENT REAL GROWTH, IT WILL BE WELL BELOW THE SEVEN TO NINE PERCENT GOP PLANNERS HAD HOPED FOR, AND NOT MUCH BETTER THAN POPULATION GROWTH.

2. THE BALANCE OF PAYMENTS CONTINUES TO BE A MAJOR SOURCE OF CON-

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CERN. EXPORTS SHOW LITTLE CHANGE FROM LAST YEAR, WHILE IMPORTS

ARE UP OVER EIGHT PERCENT, POINTING TO ANOTHER SUBSTANTIAL TRADE DEFICIT, IN THE RANGE OF \$1.2 BILLION. AID DISBURSEMENTS FROM ALL SOURCES ARE NOT INCREASING. THE MULTI-YEAR GOP IMPORT SUBSTITUTION STRATEGY OF GRADUALLY ELIMINATING WHEAT AND NITROGENOUS FERTILIZER IMPORTS OVER THE NEXT FEW YEARS WILL AT BEST ONLY REDUCE (BY 20-30 PERCENT) THE SIZE OF THE PROBLEM. A MORE COMPREHENSIVE LONG-TERM PLAN HAS YET TO BE DEvised. MEANWHILE, WE DETECT A GROWING SENSE OF URGENCY ABOUT GETTING INTERNATIONAL AGREEMENT ON NEW AID MECHANISMS.

3. ON THE OTHER HAND, INFLATION, ONE OF THE KEY PROBLEMS IN THE ECONOMY IN RECENT YEARS, SHOWS DISTINCT SIGNS OF EASING. ALSO PUBLIC SECTOR INVESTMENT IS CONTINUING TO INCREASE, AND SEVERAL KEY PROJECTS ARE MOVING AHEAD ON SCHEDULE. THIS SHOULD SET THE STAGE FOR LARGER INCREASES IN PRODUCTION IN SEVERAL KEY INDUSTRIES IN TWO OR THREE YEARS, AS NEW PLANTS COME ON STREAM. SOME LARGE SCALE PUBLIC SECTOR PLANS OF DOUBTFUL ADVISABILITY WERE SHELVED OR QUIETLY DOWNGRADED, SUCH AS THE ASIAN GAMES AND NEW INDUS HIGHWAY. PRIVATE INVESTMENT IN SERVICES, CONSTRUCTION AND FARM IMPROVEMENTS SEEMS TO HAVE RISEN, BUT LARGE SCALE PRIVATE SECTOR INDUSTRIAL INVESTMENT IS LAGGING. THIS MAY PRESENT DIFFICULT PROBLEMS FOR THE GOP IN YEARS TO COME.

4. PAKISTAN'S DEVELOPMENT GOALS ARE SOCIAL AS WELL AS ECONOMIC. THIS HAS FORCED SOME DIFFICULT COMPROMISES ON THE GOP LAST YEAR, MOST PROMINENTLY THE DECISION TO CUT, BUT NOT ELIMINATE, SUBSIDIES ON RATION-SHOP WHEAT. THIS TOO CONSIDERABLE POLITICAL COURAGE; THE GOP WILL NEED THAT COURAGE AGAIN AS SIMILAR CHOICES PRESENT THEMSELVES IN THE FUTURE. END SUMMARY.

5. GDP GROWTH: THE RECORD OF THE PAST SIX MONTHS SUGGESTS THAT GDP GROWTH IN PAKISTAN IN FY/76 WILL BE ABOVE FY/75 BUT BELOW GOP HOPES. THE FALL HARVEST OF RICE--ESTIMATED AT 2.4 MILLION TONS --IS UP SLIGHTLY FROM LAST YEAR'S PERFORMANCE--BUT WORLD PRICES ARE DOWN. THE COTTON CROP WITH A GOAL OF 4.0 MILLION BALES--IS COMING IN AT ONLY ABOUT 2.8 MILLION BALES, A DROP OF 20 PERCENT FROM THE 3.5 MILLION PRODUCED A YEAR EARLIER. THIS IS AN OMINOUS DEVELOPMENT, ESPECIALLY IN LIGHT OF THE COUNTRY'S EXPANDING LIMITED OFFICIAL USE

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TEXTILE INDUSTRY. NEXT SPRING'S WHEAT CROP IS EXPECTED TO BE A RECORD (CURRENT ESTIMATES ARE IN THE RANGE OF A RECORD 7.8/8.0 MILLION TONS), AND REPRESENTS PROGRESS TOWARD THE GOP PRIORITY GOAL OF FOOD SELF-SUFFICIENCY, THOUGH LESS THAN THE GOP HAD HOPED. OVERALL, AGRICULTURAL OUTPUT WILL PROBABLY SHOW SCANT INCREASE OVER LAST YEAR.

6. OUTPUT IN LARGE SCALE INDUSTRY OVER THE PAST SIX MONTHS SEEMS

TO BE SHOWING A MIXED RECORD. THE KEY TEXTILE SECTOR, WHICH REPRESENTS SOMETHING LIKE ONEFOURTH OF LARGE SCALE INDUSTRIAL OUTPUT IN PAKISTAN, IS STILL IN THE DOLDRUMS, WITH PRODUCTION HOLDING STEADY AT LAST YEAR'S RELATIVELY LOW RATE. AN IMPORTANT FACTOR IS UNDOUBTEDLY THE FACT THAT THE MUCH-HERALDED ECONOMIC UPTURN IN THE WEST IS A MUCH LONGER TIME IN COMING THAN HAD BEEN EXPECTED. OTHER IMPORTANT INDUSTRIES, HOWEVER, HAVE DONE BETTER. FERTILIZER AND CIGARETTE OUTPUT, IN PARTICULAR, HAVE BEEN AT RECORD LEVELS.

7. TAKEN TOGETHER, AGRICULTURE AND LARGE SCALE INDUSTRY REPRESENT ABOUT HALF OF THE ECONOMY IN PAKISTAN, AND ACCOUNT FOR MOST OF THE FLUCTUATIONS IN GDP GROWTH. WITH THEIR PERFORMANCE SHOWING ONLY A MODEST IMPROVEMENT OVER LAST YEAR, WE CAN THUS EXPECT GDP GROWHT IN REAL TERMS TO BE SOMEWHERE ABOVE LAST YEAR'S THREE PERCENT BUT BELOW THE MOST RECENT GOP OFFICIAL PROJECTIONS OF SEVEN PERECNT. (OUR OWN GUESS WOULD BE ABOUT FOUR PERCENT.)

8. BALANCE OF PAYMENTS: PAKISTAN'S TRADE DEFICIT IS EMERGING AS THE SINGLE GREATEST SHORT AND MEDIUM TERM PROBLEM THE ECONOMY FACES. WITH THE FISCAL YEAR HALF OVER, IMPORTS ARE RUNNING AT

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MANILA PASS USADB

ABOUT LAST YEAR'S RATE, AND EXPORT RECEIPTS SLIGHTLY LESS. THIS MEANS THAT IMPORTS NOW COST PAKISTAN OVER TWICE WHAT PAKISTAN EARNS FROM EXPORTS. WE STILL PROJECT A TRADE DEFICIT IN THE NEIGHBORHOOD OF \$1.2 BILLION FOR THE FISCAL YEAR.

AID DISBURSEMENTS ARE UNLIKELY TO TOP LAST YEAR'S \$1 BILLION LEVEL, OPEC AID DISBURSEMENTS, IN PARTICULAR, ARE EXPECTED TO FALL BELOW LAST YEAR'S \$500 MILLION MARK. DEBT SERVICE WILL SHOW A BIG INCREASE FROM LAST YEAR, AND WE ESTIMATE THAT IT WILL APPROACH 30 PERCENT OF EXPORT AND SERVICE INCOME. EVEN WITH SUBSTANTIAL REMITTANCES FROM PAKISTAN WORKERS IN THE GULF AND ELSEWHERE (LAST YEAR'S FIGURE TOPPED \$200 MILLION), PAKISTAN WILL ALMOST CERTAINLY HAVE TO DRAW DOWN RESERVES AND BORROW HEAVILY FROM THE IMF TO LIMITED OFFICIAL USE

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MAKE ENDS MEET.

9. PERHAPS THE SINGLE MOST TROUBLESOME PROBLEM IN THE IMPORT AREA IS THE COUNTRY'S CONTINUED HEAVY DEPENDENCE ON IMPORTED OIL AND THE SOARING OIL BILL. OIL PAYMENTS HAVE RISEN SEVEN FOLD IN THREE YEARS TIME AND ARE ESTIMATED TO COST \$400 MILLION THIS FISCAL YEAR. EXPLOITATION OF KNOWN RESERVES OF OIL AND GAS IS BEING STEPPED UP DESPITE THE RISK THAT THIS MAY RESULT IN A LOWER PERCENTAGE OF RESERVES RECOVERED. EXPLORATION CONTINUES BUT NO NEW FIELDS HAVE YET BEEN FOUND.

10. PAKISTAN'S LONG TERM STRATEGY FOR IMPROVING ITS TRADE BALANCE HAS THUS FAR RELIED ON TWO THINGS: AGGRESSIVE MARKETING OF RICE, ESPECIALLY TO ITS MUSLIM NEIGHBORS, AND ACHIEVING SELF-SUFFICIENCY IN WHEAT AND NITROGENOUS FERTILIZERS. THERE IS ALSO SOME HOPE OF INCREASING TOBACCO EXPORTS. IN THE SHORT TERM, OF COURSE, THERE HAS BEEN A THIRD ELEMENT TO GOP STRATEGY--LOOKING FOR AS MUCH AID AS POSSIBLE FROM ANY AVAILABLE SOURCE.

11. GOP PLANNERS ARE BECOMING INCREASINGLY AWARE, HOWEVER, THAT THIS STRATEGY WILL AT BEST ONLY REDUCE THE SIZE OF THE PROBLEM. RICE MARKETING BRINGS IN EXPORT REVENUES ONLY SO LONG AS THE PRICE IS RIGHT AND DEMAND EXISTS, AND THIS YEAR'S FALLING PRICES HAVE DEMONSTRATED THE MARKET'S VOLATILITY. ELIMINATING WHEAT AND FERTILIZER IMPORTS, MOREOVER, WOULD ONLY REDUCE THE IMPORT BILL BY \$250-400 MILLION, AND EVEN CONCESSIONAL AID MUST EVENTUALLY BE REPAYED. THERE SEEMS TO US TO BE LITTLE COHERENT THINKING ABOUT

OTHER LONG TERM MEASURES PAKISTAN MIGHT TAKE, OTHER THAN A GROWING SENSE OF URGENCY ABOUT GETTING INTERNATIONAL AGREEMENT ON NEW AID MECHANISMS (SUCH AS IFAD, THE IMF TRUST FUND, AND THE THIRD WINDOW).

12. INFLATION: ONE DISTINCT IMPROVEMENT IN THE PICTURE IS A SHARP DROP IN THE INFLATION RATE IN THE PAST SIX MONTHS. PRICE INCREASES HAVE SLOWED TO AN ANNUAL RATE OF 10-15 PERCENT AS OF THE END OF 1975, COMPARED WITH LAST YEAR'S 24 PERCENT. MONEY SUPPLY, TOO, HAS BEEN INCREASING MORE SLOWLY THAN LAST YEAR.

13. INFLATIONARY PRESSURES MAY INCREASE DURING THE SECOND HALF OF THE YEAR. THE POFXR PERFORMANCE OF EXPORTS AND THE COMPOSITION LIMITED OFFICIAL USE

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OF IMPORTS HAVE KEPT RECEIPTS FROM FOREIGN TRADE TAXES, THE MAINSTAY OF THE GOP REVENUE SYSTEM, BELOW ESTIMATES, AND THE RESULT WILL ALMOST CERTAINLY BE A LARGER THAN ANTICIPATED BUDGET DEFICIT. THE FINANCING REQUIREMENTS OF PAKISTAN'S DEVELOPMENT PROJECTS WILL ALSO PUT PRESSURES ON THE MONEY SUPPLY. NONETHELESS, WE EXPECT PRICE INCREASES THIS FISCAL YEAR TO BE WELL BELOW LAST YEAR'S.

14. INVESTMENT: LOOKING TO THE FUTURE, PAKISTAN'S ECONOMIC GROWTH WILL DEPEND IN LARGE MEASURE ON INVESTMENTS BEING MADE NOW. HERE, ONCE AGAIN, WE MUST REPORT MIXED RESULTS.

15. INVESTMENT IN PUBLIC SECTOR INDUSTRIES CONTINUES TO INCREASE. RECENT FIGURES ARE UNAVAILABLE, BUT IT IS CLEAR THAT MANY OF THE PUBLIC SECTOR PROJECTS NOW ON THE DRAWING BOARDS ARE MOVING AHEAD AT A REASONABLE RATE. ONE MAJOR PUBLIC SECTOR FERTILIZER PLANT, CEMENT AND SUGAR MILLS, SOME TEXTILE PLANTS FINANCED BY IRAN, AND THE RUSSIAN-FINANCED STEEL MILL ARE ALL MAKING PROGRESS. A NUMBER OF THESE PROJECTS ARE EXPECTED TO COME INTO PRODUCTION IN FY 1977-78, AND SHOULD RESULT IN A SUBSTANTIAL INCREASE IN PRODUCTIVE CAPACITY IN CERTAIN BASIC INDUSTRIES NOW RESERVED TO THE PUBLIC SECTOR.

16. INVESTMENT IN THE PRIVATE SECTOR HAS BECOME A MUCH SMALLER PERCENTAGE OF PAKISTAN'S TOTAL INDUSTRIAL EFFORT THAN HAD EARLIER BEEN THE CASE. LAST YEAR'S PERCENTAGE WAS IN THE NEIGHBORHOOD OF ONE-THIRD, AND THE ANNUAL PLAN PROJECTIONS FOR THIS YEAR SHOWED THE PRIVATE SECTOR CONTRIBUTING ONLY SOME 29 PERCENT OF TOTAL INVESTMENT. THIS COMPARES WITH 54 PERCENT AT THE HIGH POINT OF PRIVATE INVESTMENT IN 1974-65. THE VOLUME OF PRIVATE INVESTMENT HAS ALSO DROPPED DURING THIS PERIOD. IN FY 1975, PRIVATE INVESTMENT AS A WHOLE INCREASED IN REAL TERMS FOR THE FIRST TIME IN TEN YEARS. THE FEW BITS OF INFORMATION WE HAVE SUGGEST THAT PRIVATE INVEST-

MENT IS THUS FAR SHOWING LITTLE INCREASE OVER LAST YEAR. MILL OWNERS ARE REINVESTING MUCH LESS OF THEIR PROFITS IN THEIR ENTERPRISES; THE TYPICAL ATTITUDE IS TO INVEST IN GOVERNMENT BONDS WHICH ARE TAX-EXEMPT AND "FREE OF LABOR PROBLEMS". ACCORDING TO GP STATISTICS, PRIVATE INVESTMENT IS AT OR ABOVE 1969/70 LEVELS (IN REAL TERMS) IN AGRICULTURE, TRANSPORT AND HOME OWNERSHIP. IN LARGE SCALE MANUFACTURING, HOWEVER, THE DROP HAS BEEN PRECIPITATE. LIMITED OFFICIAL USE

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FY 75 PRIVATE LARGE SCALE INVESTMENT, ADJUSTED FOR INFLATION, WAS ABOUT 70 PERCENT BELOW THE FY 70 LEVEL. THE INDICATIVE PLANNING FIGURE FOR FY 76, SIMILARLY ADJUSTED, IS NEARLY 65 PERCENT BELOW FY 70.

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18. SOME OF THIS SLACK HAS BEEN TAKEN UP BY INCREASED PUBLIC SECTOR INVESTMENT SINCE THE 1972 NATIONALIZATIONS. BUT EVEN INCLUDING THOSE PARTS OF INVESTMENT IN NATIONALIZED INDUSTRIES FUNDED OUTSIDE THE GOP BUDGET, INDUSTRIAL INVESTMENT PLANNED FOR FY 76 REMAINS ABOUT 30 PERCENT BELOW THE FY 70 LEVEL. AGAINST THIS, SMALL SCALE PRIVATE INDUSTRY IS GENERALLY CONCEDED TO BE MORE DYNAMIC THAN THE LARGE SCALE PRIVATE SECTOR, AND MORE DYNAMIC THAN GOP FIGURES INDICATE. BUT THIS IS A RELATIVELY SMALL PERCENTAGE OF THE TOTAL. IN SHORT, INDUSTRIAL INVESTMENT AS A WHOLE DOES NOT APPEAR TO HAVE EXCEEDED THE FY 1970 LEVEL IN REAL TERMS, AND THE PRIVATE SECTOR IS PLAYING A MUCH SMALLER ROLE IN INDUSTRY THAN IT ONCE DID.

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19. SOCIAL GOALS AND ECONOMIC PERFORMANCE:PAKISTAN'S ECONOMIC GOALS ARE NOT, OF COURSE, LIMITED TO GROWTH IN GDP AND IMPROVEMENT IN THE BALANCE OF PAYMENTS THIS GOVERNMENT IS ALSO COMMITTED TO IMPROVING THE LOT OF THE AVERAGE PAKISTANI, TO PROVIDING, IN THE WORDS OF THE PPP MANIFESTO, "BREAD, CLOTHS AND SHELTER."THERE IS EVIDENCE OF INCREASINGLY SERIOUS ATTENTION TO POPULATION PLANNING. TWO ASPECTS OF THESE SOCIAL ASPIRATIONS DESERVE COMMENT TO ROUND OUT OUR YEAR-END ASSESSMENT.

20. FIRST, ALTHOUGH ECONOMIC GROWTH AND IMPROVEMENT IN THE WELFARE OF THE AVERAGE PAKISTANI ARE COMPLEMENTARY IN THE LONG RUN, THERE ARE TRADE-OFFS WHEN IT COMES TO SHORT-TERM POLICY MEASURES. FOR THE PAKISTAN GOVERNMENT, TWO OF THESE TRADE-OFFS HAVE BEEN PARTICULARLY IMPORTANT: THE COMPETITION FOR BUDGETARY RESOURCES FOR SUCH LONG-TERM (BUT NON-REVENUE PRODUCING) GOALS AS PRIMARY EDUCATION, IMPROVED HEALTH SERVICES AND FAMILY PLANNING, AND THE CONFLICT BETWEEN THE DESIRE FOR CHEAP FOOD FOR POOR (ESPECIALLY URBAN) PAKISTANIS AND THE NEED FOR AN ADEQUATE RETURN AND PRODUCTION INCENTIVES FOR THE FARMER. IN BOTH AREAS, THE GOP HAS TRIED TO FIND A COMPROMISE SOLUTION--IN THE BUDGET, FOR EXAMPLE, BY EMPHASIZING BOTH "SOCIAL EXPENDITURES" AND MAJOR ECONOMIC INVESTMENTS AT THE EXPENSE OF TRANSPORT AND OTHER INFRASTRUCTURES, AND BY CUTTING, BUT NOT ELIMINATING RATION SHOP FOOD SUBSIDIES WE EXPECT THAT SIMILAR CHOICES, REQUIRING, IN ALL LIKELIHOOD, SIMILAR DIFFICULT COMPROMISES, WILL CONTINUE TO CONFRONT THE GOP. EVEN WITHIN THE SOCIAL SECTORS THERE ARE IMPORTANT, BUT POLITICALLY DIFFICULT CHOICES TO BE MADE--FOR EXAMPLE, BETWEEN PRIMARY EDUCATION AND MORE COLLEGE AND UNIVERSITY EDUCATION, BETWEEN BASIC HEALTH SERVICES AND MORE HYSICIAN CENTERED URBAN MEDICAL INVESTMENTS.

21. SECOND IS THE PROBLEM OF ASSESSING CHANGES IN SECTORAL LIVING STANDARDS. HARD EVIDENCE IS HARD TO COME BY, BUT THERE IS SOME AGREEMENT THAT OVER THE LAST FEW YEARS URBAN LABOR AND FARMERS HAVE BECOME BETTER OFF AND THAT THE SALARIED MIDDLE CLASS IS WORSE OFF. WHOLESALE PRICES OF FOOD HAVE INCREASED MORE RAPIDLY IN THE PAST FEW YEARS THAN THOSE OF MANUFACTURES. SUCH PRICE INDICES MUST BE READ WITH CAUTION, BUT THEY WOULD APPEAR TO SUGGEST AN IMPROVEMENT IN RURAL INCOME. WORKER BENEFITS IN INDUSTRY HAVE ALSO GONE UP SIGNIFICANTLY. THE FACT THAT FOOD SOLD THROUGH LIMITED OFFICIAL USE

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THE SUBSIDIZED URBAN RATION SHOP SYSTEM HAS BEEN INCREASING AT A RATE SEVERAL TIMES FASTER THAN URBAN POPULATION GROWTH SUGGESTS AN IMPROVEMENT IN PER CAPITA FOOD CONSUMPTION IN URBAN AREAS. THE REDISTRIBUTIVE EFFECT OF THE RECENT LAND REVENUE REFORMS, THOUGH MINOR, IS TOWARD THE SMALL LANDHOLDER. TENANT FARMERS HAVE BEEN MADE MORE SECURE IN THEIR TENANCY. AS AGAINST THE ABOVE BENEFITS, THE SALARIED MIDDLE CLASS SEEM TO HAVE SUFFERED THE GREATEST SQUEEZE IN RECENT YEARS, WITH SALARIES LAGGING BEHIND INFLATION. THE EASING OF INFLATION SHOULD PROVIDE SOME RELIEF TO THIS ELEMENT. THE WEALTHY, IT APPEARS HAVE BEEN HOLDING THEIR OWN. COMPARED WITH THE PPP'S AMBITIOUS GOALS, THIS IS NOT MUCH, BUT IT DOES SUGGEST THAT SOME REDISTRIBUTION OF INCOME SHARES IS TAKING PLACE--ALBEIT AT THE EXPENSE OF THE MIDDLE CLASS.

22. THIS INCLUDES A CONTRIBUTION BY CONGEN LAHORE.  
BYROADE

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## Message Attributes

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